April 23, 2021

Value stocks, back in vogue?

Though we remain in the grip of the pandemic, markets are forward-looking. Already in 2021, investors have been prepping their portfolios for a bright, post-pandemic future, ushered in by ultra-accommodative monetary and fiscal policies and amplified by pent-up demand. According to Moody's, globally, households have amassed $5.4tn in savings through the pandemic and analysts expect that once restrictions are eased, this money will be – at least partially – released into the economy. As the macro outlook brightens, many are pondering whether it's time to swivel towards Value stocks.

Value investing typically means looking past glitzy, high-flying names to consider "unloved" companies with less pizzazz. Value stocks tend to trade at a discount to fundamental metrics such as book value, earnings, sales or dividends… and are most prevalent in industries such as Financials, Materials, Airlines and Retail. Investors typically buy Value stocks when the economy is in an expansionary phase, when corporate profits are rising, when the expectations for long-term interest rates are moving upwards and when a "risk-on" mode permeates through markets. In contrast to Value stocks, Growth stocks are equities of companies with strong anticipated growth potential; a textbook example would be the FAANGs or constituents of the NASDAQ index. Because Growth stocks derive much of their value from expectations about future earnings, they are vulnerable to rising inflation expectations and increases in bond yields.

VALUE VERSUS GROWTH

Over a lengthy time horizon, Value styles have slightly outperformed Growth, but the outperformance comes in long cycles which are correlated to the fixed income market. In the past thirty years, against a prolonged bull market in bonds, Value has lagged behind Growth – but not without bouts of overperformance.

After the world came to a standstill in 2020, the mood was definitely risk-off and Covid fears drove Value stocks to near-record lows relative to Growth. Many stocks in the latter category were key beneficiaries of the stay-at-home theme (e.g. IT stocks that permitted teleworking, online retailers, and social media networks…) while central banks adopted "whatever it takes" policy and cut rates (bad news for banks). Across the whole of 2020, the S&P 500 Value index delivered total returns of just 1.4%; well below the 18.4% returns of the entire S&P 500 index and in a different orbit to the 33.5% returns offered by the Growth index.

VALUE STOCKS IN 2021

The performance of Value stocks is largely tethered to interest rates. These have been rising (though not unabatedly) as the vaccination rollout gains traction and as the economic outlook improves. As such, we have already witnessed some rotation from Growth names into Value, though the latter is still clearly cheaper in terms of valuations. As the stay-at-home theme is gradually replaced by a new narrative of "reopening and recovery" we see potential for Value stocks to catch up further, though there may be some false starts.

For this reason, we have only added a Value tilt to our US exposure, believing that in this region, the recovery narrative is more sturdy (it is expected that every adult will be eligible for vaccination before the end of April and Joe Biden is unleashing trillions in fiscal spending). Europe is traditionally a Value play, but we believe its pathway out of the pandemic will be less straightforward than elsewhere – still today, ten EU member states have yet to ratify the bloc's

750 billion euro recovery spending. If there is a sudden reversal of optimism or a downturn in data, it would be painful for investors to get caught on the wrong side of the Growth/ Value trade.

Most market commentators characterize Warren Buffett as a Value investor. But as Buffett clearly states, a smart investor should consider both Value and Growth investing, with an opportunistic mindset when it comes to style preference, in accordance with the current context.

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